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SUBJECT: DISARRAY OVER CENTRAL BANK GOVERNOR SYMPTOMATIC OF GOT DECISION-MAKING

REF: A. ANKARA 1409

¶B. ANKARA 1332 AND PREVIOUS

Classified By: Economic Counselor Tom Goldberger for reasons 1.4(b) and (d).

¶1. (C) Summary: The process of selecting a new Central Bank Governor moved from comedy to farce as President Sezer and Prime Minister Erdogan traded confusing statements about the state of play. The disarray over selection of a new Central Bank Governor reflects Erdogan's pro-Islam ruling Justice and Development Party (AKP) government's tendency to take a last-minute, reactive approach to decisions, and to see how far they can go without crossing a confrontational line with the secular establishment. The Government's handling of the Central Bank appointment also reflects a pattern of the GOT gradually asserting control over independent boards and key elements of the bureaucracy. While it is the elected Government's prerogative to make official appointments, secularists contend AKP is going further than earlier governmnts and question the new appointees' ability o make independent decisions. End Summary.

Central Bank Appointment Process Turns Farcical

¶2. (SBU) With outgoing Central Bank Governor Serdengeceti's term having ended March 14, the name of his replacement remains unknown. The Central Bank board named Vice-Governor Erdem Basci as Acting Governor March 13, and Basci was widely expected to be nominated by the GOT to be confirmed as Governor by President Sezer. However, when Minister Babacan met with Sezer on March 14, neither made any public statement. Markets and press widely assumed Basci would be the Government's choice, since Basci was considered both qualified and close to the Government (see reftels). There was speculation -- which has recently increased -- that the staunchly-secular Sezer might resist the appointment of AKP-connected Basci, with the press highlighting that Basci's wife wears a headscarf, anathema to Turkey,s secular establishment.

¶3. (SBU) Events took a farcical turn March 21, when President Sezer's office announced it had not received a decree from the Government proposing Basci's name. Markets fell sharply on the news, but recovered later

in the day when PM Erdogan said the Government had indeed sent the President a decree but that the President should be the one to announce the name. There is widespread speculation, including in the press, that the reason for the confusing statements is that Sezer rejected Basci's candidacy, causing the Government to withdraw the nomination and propose another name. Whatever the reason, the two statements have led to a popular consensus view that Basci will not be the new Governor. Speculation now centers on Adnan Buyukdeniz. Buyukdeniz is the CEO of an Islamic bank, Al-Baraka Turk, of which controversial Finance Minister Unakitan was a director. Buyukdeniz also co-founded with Unakitan a textile company in 1999. Buyukdeniz studied at the London School of Economics where he was a classmate of Turkey's IMF Resident Representative Hugh Bredenkamp. The name remains a mystery: even Government Ministers may not know -- they were reportedly asked to sign a decree with the name of the nominee left blank.

¶4. (SBU) In addition to the confusion over the Governorship, the Government will be in a position to name three new Vice-Governors -- a complete turnover of senior management of the Bank, unless Basci stays on either as Governor or Vice-Governor. In February, Vice-Governor Fatih Ozatay announced that he will retire, and Vice-Governor Sukru Binay announced only last week that he would retire, reportedly after having been slighted by the appointment of Basci as Acting Governor despite Binay's seniority. This means the March 23 monetary policy committee meeting will be the last with old guard Vice-Governors Ozatay and Binay. With daily articles speculating about whom the Government will appoint as Vice-Governors, the secularist press has seized on the possible nomination of

Ibrahim Turhan, an Islamist who has written articles criticizing the U.S., free markets, and privatization. The AKP government appointed Turhan to the Central Bank's board (but not the monetary policy committee) in 2004.

The AKP Style -- Reactive, Experimental, but Stopping Short of Confrontation

¶5. (C) The AKP's handling of the selection of a new Central Bank Governor is the latest manifestation of the Government's approach to difficult decisions. As with the decision to renew the IMF program in 2004, the GOT tends to wait until the last minute, ostensibly keeping its options open, and then only taking action when it absolutely needs to. Serdengecti complained to us months ago that the GOT should decide who it wanted to be Central Bank Governor and start preparing an orderly transition. Capital Markets Board Chairman Dogan Cansizlar told us he believes the GOT waited so that Serdengecti, hoping to be reappointed, would refrain from publicly criticizing the GOT. Whatever the motivation, the GOT's procrastinating decision-making in this case was risky, given the possibility of market uncertainty, particularly with the IMF program stalled and looming problems with the EU process.

¶6. (C) The AKP government also tends to float trial balloons, seeing how far it can go, particularly on any decision likely to be deemed controversial by the secular establishment. As it did with various proposals about religious (imam hatip) schools and a 2004 proposal to re-criminalize adultery, the Government appears to have informally proposed an idea and then pulled back when the controversy threatened to cross the line into direct confrontation.

AKP's Slow-Motion Takeover of the Independent Boards

¶ 7. (C) The Central Bank appointments story is also the latest in a pattern of AKP appointments to independent boards, that appear aimed at reducing the power of senior officials appointed by previous governments. In 2000 and 2001, as Turkey grappled with the failure of the 1990's coalition governments' economic policies, a series of independent boards were established to insulate key areas of economic regulation from direct political influence. Among these were the independent Central Bank, the Bank Regulatory and Supervisory Agency, the Energy Regulatory Board, the Telecoms Regulatory Board, the Government Procurement Board, and the Competition Authority. As these Board members' terms have expired, the AKP government has gradually inserted people with close ties to the AKP. The GOT also passed a law standardizing certain features of the independent boards, thereby reducing the boards' financial independence.

¶ 8. (C) The AKP government has been adept at increasing its power over independent boards, as when it took advantage of the 2003 Imar Bank collapse to pressure Bank Regulatory Agency Chairman Engin Akcaca to resign. Another example was the use of the IFI-supported Public Financial Management and Control law, which decentralized the state audit function, to curtail the powers of the independent-minded Financial Inspection Board. The Financial Inspection Board, an elite inspector corps dating from Ottoman times and modeled on the French Financial Inspectors, had sweeping powers to investigate corruption and criminality. Financial Inspection Board Chairman Mehmet Tuncer complains bitterly to us about the AKP government and its restrictions on the Board's powers, strongly implying that Finance Minister Unakitan, in particular, was clipping the Board's wings because the Board has files on Unakitan's corruption.

¶ 9. (C) Capital Markets Board Chairman Dogan Cansizlar, another holdover from pre-AKP days, complained at length to us about the AKP government's appointment of 10 board members to his organization in February 2005. He told us the new appointees have interfered in

administrative decisions in an attempt to squeeze Cansizlar. Cansizlar and other secularists contend that AKP has replaced even mid-level officials, and has uprooted a lower level of the bureaucratic hierarchy than previous governments did.

At Treasury, for example, AKP has replaced officials down to the Director General level. President Sezer has refused to confirm many of these AKP-appointed officials, meaning that the upper levels of the bureaucracy include many "Acting" officials.

Genc Osman Yarasli, for example, has been Acting President of the anti-money laundering agency (MASAK) for three years. Cansizlar said there are 23 acting officials at the Capital Markets Board alone.

The Question of Independence

¶ 10. (C) Partisan appointments are a normal feature of Turkey's or any democracy's political landscape. With criticism of AKP appointments coming mostly from secularists, it is difficult to distinguish between legitimate complaints and sour grapes over the pro-Islam AKP government's exercise of its right to appoint officials. Compounding the difficulty is the fact that Turkey's powerful state bureaucracy, with a

top-down approach to policy-making, has traditionally been stacked with secularists trained in elite schools. AKP supporters frame the issue in terms of an increase in democratic control over the bureaucracy; secular opponents depict it as an infringement on a desirable tradition of non-political boards and career bureaucrats. The AKP government's appointments have sometimes enabled the regulators to be more effective, most notably when the GOT backed up Ahmet Erturk at the Savings Deposit Insurance Fund in his forceful actions the Uzans and other owners of failed banks. The critics are on stronger ground in questioning new appointees' ability to take an independent line in regulatory decisions. More than any other board, the Central Bank's independence is crucial to effective monetary policy. As Serdengecti said to us, even if the new Governor is well qualified, will he have the stature and independence to resist pressures from the politicians who appointed him?

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